Stock Story: Alibaba

An out-there e-commerce company has become critical to China's digital transformation.

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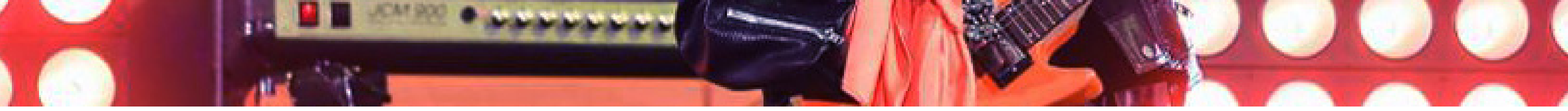
Top this for a company head's farewell to staff. A tearful Alibaba co-founder Jack Ma wore oversized purple-tinged glasses, a studded leather jacket with chains and a braided long-haired wig and sang Chinese pop songs accompanied by two other co-founders, a rock-star-decked Lucy Peng, and Joe Tsai, who opted for a 'Marilyn Monroe'-style dress and a blonde wig. And these were just some of the antics at a four-hour celebration in front of 60,000 employees in September last year in the eastern Chinese city of Hangzhou to mark Ma's achievements and the e-commerce giant's 20th birthday.[1]

The company that earned 377 billion yuan (US$56 billion) in revenue in fiscal 2019 had much to celebrate. Alibaba, with more than 60% market share, is the leading e-commerce marketplace operator in China, which is one of the world's fastest-growing online retail markets thanks to rising incomes, the proliferation of smartphones and the fact that traditional western-style retailing never fully developed in the country. Alibaba's domestic consumer-to-consumer platform Taobao (launched in 2003) and its business-to-customer platform Tmall (launched in 2008) that houses the world's most valuable brands have 820 million monthly users today. The platforms generate transactions worth almost US$950 billion a year, an amount twice that of Amazon's. Alibaba is behind the world's largest shopping event; the company's annual 'Singles Day', which on November 11 last year notched a record US$38.4 billion in sales across Alibaba's main e-commerce sites.

And e-commerce is just one of Alibaba's businesses. The company has used the profits from its lucrative e-commerce arm to expand into other large, fast-growing and often-complementary industries. Two of its most promising businesses include Alibaba Cloud Intelligence (founded in 2009), which is one of the world's largest cloud-computing businesses, and Ant Financial (established in 2004, 33% owned by Alibaba), which is China's largest payments and digital financial services platform. In addition, Alibaba operates China's leading digital advertising platform, emerging international e-commerce platforms (AliExpress and Lazada), one of China's leading online-food delivery and local-services platforms (Ele.me), a logistics business that supports the delivery of millions of items daily (Cainiao), a grocery business pioneering online-offline integration (Hema) and a leading digital media and entertainment business (Youku). Together, these businesses are supporting enterprise digitalisation in China and, in aggregate, have helped Alibaba notch revenue growth of 48% p.a. over the past five years.

Alibaba is well placed to record impressive earnings growth in coming years. The company is positioned to benefit from growing consumer spending in China and rising online penetration in rural cities. Network effects, user data insights, economies of scale and an ability to outspend competitors are sealing Alibaba's market supremacy across many e-commerce segments. The synergies across Alibaba's many units attract and retain people to its sites, which presents opportunities to cross-promote, hone algorithms and monetise data through targeted ads. The cloud arm, which is twice the size of its next Chinese rival, is well positioned to add to its 1.4 million paying customers that include more than half of the A-share listed companies in China and 80% of Chinese technology companies. All up, Alibaba's wide reach presents as a unique opportunity to benefit from China's digital transformation and shift to a consumption economy.

Alibaba comes with risks, to be clear. One that is common to Chinese stocks is that, to skirt government restrictions on foreign ownership of 'sensitive' businesses, foreign investors can gain exposure to Alibaba only by investing in 'variable interest entity' structures where they don't own shares in the operating companies directly. Another risk is interference from the Chinese government and its omnipotent regulatory powers. Although these market nuances create uncertainty for foreign shareholders, the probability of them transpiring into material shareholder losses for high-profile companies such as Alibaba is considered to be low, particularly given the importance of foreign capital to the Chinese economy. Another risk is that Alibaba competes for the attention and business of Chinese consumers in a dynamic market against the formidable Tencent, JD.com and Meituan-Dianping. Notwithstanding the intense competition, Alibaba is likely to deliver the earnings growth in coming years that justify its risks.



FOUR REPORTING SEGMENTS

In 1999, Ma was one of 18 people who gathered in his small, shared apartment in Hangzhou to form Alibaba. The company's first initiatives were to create the English-language global wholesale marketplace Alibaba.com and a domestic-based marketplace, now known as 1688.com, for domestic wholesale trade. By the end of 2001, Alibaba.com had more than one million registered users and within another 18 months the company was profitable.

Skip to 19 September 2014 and Alibaba, after 15 years of excelling in e-commerce and branching beyond by organic investment, acquisition, forming alliances and minority investments, emerged as one of the world's most valuable technology companies, raising a record US$25 billion for its New York Stock Exchange debut.

Alibaba's secondary listing on the Hong Kong Stock Exchange in 2019 was just as successful for the company now under CEO Daniel Zhang that reports its earnings across four key segments. The 'core commerce' division earned 86% of group revenue in fiscal 2019 from commission fees, memberships and advertising on Alibaba's e-commerce platforms. Core commerce also includes revenue generated from the sale of goods (i.e. first-party sales), primarily through Alibaba's New Retail initiative, Hema, as well as revenue generated from the provision of logistics services (through Cainiao) and local services (through Ele.me and Koubei).

The next most important division is cloud computing, which earned 7% of Alibaba's revenue by providing cloud solutions. The unprofitable 'digital media and entertainment' segment attracted 6% revenue from membership fees and advertising. This revenue was mainly derived from Alibaba's online video platform, Youku, and online browser, UCWeb, as well as through diverse content platforms that provide film, online ticketing, music, news, literature and gaming.

The other division is the loss-making 'innovation initiatives and others' segment, which earned 1% of revenue. Within this division are found the company's operating system, navigation technology, AI-powered voice assistants and smart speakers, and enterprise-communication software, where revenue is typically generated through software or annual fees.

With so many dominant positions across so many industries likely to ensure that these four segments generate strong growth over time, the party marking Alibaba's next birthday of note could be the most bizarre yet.

Sources include company filings and website, Bloomberg and Hoover's, a Dun & Bradstreet Company.

1 See Reuters. 'Tearful Ma bids Alibaba farewell with rock star show.' 9 September 2019. reuters.com/article/us-alibaba-jackma-idUSKCN1VU0VY

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